

Bank of China (BOC) [3988.HK]

Net Profit grew by 8.08%; Potential beneficiary of "Going-out" policy; Maintain BUY

Bank of China (BOC) [3988.HK] reported net profit of RMB169,595 m for 2014, up 8.08 % year-on-year (YoY), slightly higher than market consensus (7.05%) but lower than our forecast (12.5%) mainly due to larger impairment losses on assets arising from a sharp increase of non-performing loans (NPLs) (impairment losses jumped by 105% to RMB48,381m from RMB23,510m, NPL ratio jumped to 0.96% from 1.18%). Formerly the China's official foreign exchange and trade bank, BOC is in a perfect position to take advantage of the "Going-out" policy. Assets and pre-tax profit of overseas business accounted for 27.41% and 22.98% of total amount in 2014, significant higher than all other China banks, which helps BOC to diversify the risk of interest rate liberalization and credit crunch. Volume of international RMB settlement/clearing grew by 33.7%86.6%, maintaining its leading global position. As the interest rate liberalization will likely come sooner than our previous expectation, together with the negative impact on non-interest income growth from Measures for the Administration of the Service Prices of Commercial Banks issued in Aug last year, we slightly trim our net profit growth for 2015E from 10.64% to 9.89%. Maintain **BUY** with a target price of **HK\$5.90**.

- 2014 results highlights:** Net profit grew by 8.08% to RMB169,595m. Net interest income increased by 13.23% to RMB354,596m. Non-interest income rose by 9.12% to RMB135,226m. Total loans were up by 11.51% while total deposits grew by 7.8%. Cost-to-income ratio down from 30.61% to 28.57% as the increase in costs was slower than that of revenue. The bank increased its provision rate to 2.68% from 2.62% to handle the deteriorating credit issue. Tier 1 CAR and CAR increased to 10.61% and 13.87% because of the issuance of preference shares (RMB72bn during 2014).
- Stable NIM and non-interest income growth; large overseas exposure to mitigate the impact of interest rate liberalization:** BOC's net interest margin increased by 0.01ppt to 2.25% in 2014, lower than the sector average of 2.7% since BOC has larger overseas business. However, we think the overseas business is an advantage under the current situation that the interest rate liberalization process will likely proceed faster than expected, as it has more experience in competing under the environment of full interest liberalization. In addition, the portion of interest income from overseas business will not affect by interest rate reform which can help to stabilize the interest income growth. We expect net interest margin of BOC to shrink gradually but the pressure will be smaller than its peers.
- NPLs are manageable; tough valuation at 5.3x/0.8x 2015E PER/PBR; Maintain BUY.** Although NPL ratio increased to 1.18% (lower than the sector average 1.25%) from 0.96%, BOC could still manage its risk as its provision coverage ratio was still at 227% at the end of 2014. We think the worst is over considering the government will keep injecting liquidity into the market and there will likely be more interest rate cut to ease the burden on borrowers. BOC is currently trading at 5.3x/0.8x 2015E PER/PBR, maintain **BUY** with TP **HK\$ 5.9**.

Figure 1: Key Financials

Key Financials	2011	2012	2013	2014	2015E	2016E
Net interest income (RMBm)	228,064	256,964	283,585	321,102	354,596	376,626
- Change (%)	17.58%	12.67%	10.36%	13.23%	10.43%	6.21%
Non interest income (RMBm)	100,234	109,212	123,924	135,226	148,306	163,029
- Change (%)	21.41%	8.96%	13.47%	9.12%	9.67%	9.93%
Net Profit (RMBm)	124,276	139,656	156,911	169,595	186,374	203,041
- Change (%)	18.81%	12.38%	12.36%	8.08%	9.89%	8.94%
NPL ratio (%)	1.00%	0.95%	0.96%	1.18%	1.15%	1.12%
Net Interest Margins (%)	2.12%	2.15%	2.24%	2.25%	2.21%	2.12%
PER (x)	7.9	7.1	6.3	6.1	5.3	4.9
PBR (x)	1.5	1.2	1.1	0.9	0.8	0.7
ROE (%)	18.32%	18.13%	18.04%	17.28%	14.56%	13.65%
ROA (%)	1.17%	1.19%	1.23%	1.22%	1.22%	1.21%
DY (%)	4.39%	4.95%	5.55%	5.38%	6.17%	6.71%

Source: Company, CGIHK Research

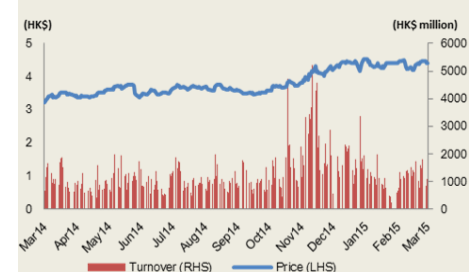
China Banking Sector

BUY

Close: HK\$ 4.40 (Mar 25th, 2015)

Target Price: HK\$5.90 (+34%)

Price Performance



Market Cap	US\$193,318m
Shares Outstanding	294,387.8m
Auditor	Ernst & Young
Free Float (H-share)	91%
52W range	HK\$3.25—4.57
3M average daily T/O	US\$48m
Major Shareholder	Central Huijin 67.7%

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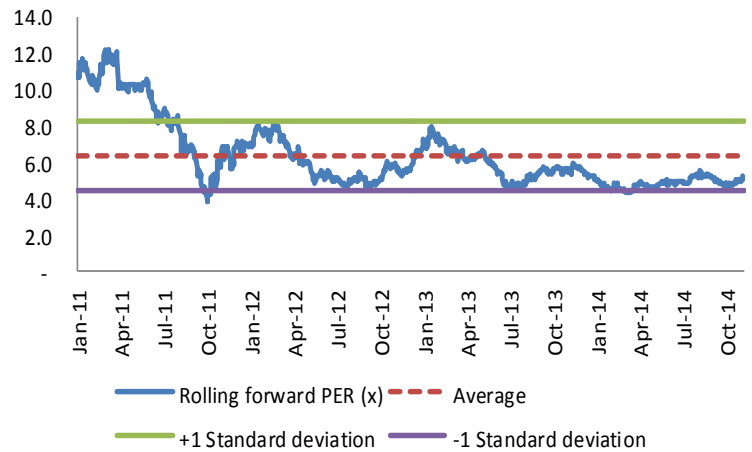
Figure 2: Income Statement & Balance Sheet

(Unit: Millions of RMB)	2012	2013	2014	2015E	2016E
Income statement					
Interest income	506,528	518,995	602,680	684,042	745,606
Interest expense	-249,564	-235,410	-281,578	-329,446	-368,980
Net interest income	256,964	283,585	321,102	354,596	376,626
Fee and commission income	75,198	88,585	98,538	107,406	117,073
Fee and commission expense	-5,275	-6,493	-7,298	-8,101	-8,854
Net fee and commission income	69,923	82,092	91,240	99,306	108,219
Net trading gain/loss	8,451	7,183	11,099	13,000	14,560
Net gain/loss on financial instruments designated as at fair value through profit or loss	2,288	594	1,795	2,000	2,250
Other operating income, net	28,550	34,055	31,092	34,000	38,000
Operating income	366,176	407,509	456,328	502,901	539,655
Operating expenses	-179,116	-195,824	-226,169	(248,936)	(264,431)
Operating Profit	187,060	211,685	230,159	253,965	275,224
Share of profits of associates and jointly-controlled entities	613	1,092	1,319	1,250	1,300
Profit before tax	187,673	212,777	231,478	255,215	276,524
Income tax expense	-41,927	-49,036	-54,280	-60,741	-64,983
Net profit	145,746	163,741	177,198	194,474	211,541
Profit attributed to shareholder	139,656	156,911	169,595	186,374	203,041
Non-controlling interests	6,090	6,830	7,603	8,100	8,500
(%)	2012	2013	2014E	2015E	2016E
Key Ratios					
P/B:	1.2	1.1	0.9	0.8	0.7
P/E:	7.1	6.3	6.1	5.3	4.9
Loan-to-deposit Ratio:	72.0%	72.5%	78.3%	80.3%	81.8%
Net interest income growth:	12.7%	10.4%	13.2%	10.4%	6.2%
Non interest income growth:	9.0%	13.5%	9.1%	9.7%	9.9%
Profit Growth:	12.4%	12.4%	8.1%	9.9%	8.9%
NPL Ratios:	1.0%	1.0%	1.2%	1.2%	1.1%
Interest Margin:	2.2%	2.2%	2.3%	2.2%	2.1%

Source: Company, CGIHK Research

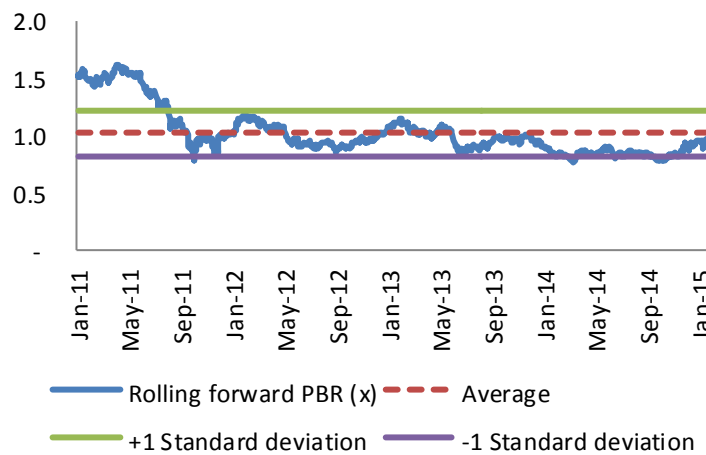
(RMB m)	2012	2013	2014	2015E	2016E
Balance sheet					
Assets:					
Cash and deposits with central bank	1,934,297	2,132,001	2,306,088	2,378,732	2,402,520
Due from banks and non-bank financial institutions	1,222,873	1,362,633	1,291,851	1,556,916	1,665,900
Loans and advances to customers	6,710,040	7,439,742	8,294,744	9,207,166	10,127,882
Financial investments	2,280,236	2,330,932	2,758,342	2,903,111	3,251,484
Property and equipment	150,324	158,968	172,197	191,387	197,128
Deferred tax assets	21,292	22,928	25,043	27,108	28,735
Other assets	361,553	427,095	403,117	460,316	506,347
Total assets	12,680,615	13,874,299	15,251,382	16,724,736	18,179,997
Liabilities					
Due to central banks	130,022	200,939	348,271	369,167	424,542
Derivative financial liabilities	32,457	36,212	40,734	41,012	44,498
Due to banks and non-bank financial institutions	1,936,929	1,973,101	2,082,184	2,447,475	2,606,560
Due to customers	9,173,995	10,097,786	10,885,223	11,777,811	12,720,036
Income tax payable	34,994	40,031	41,636	44,218	48,640
Deferred tax liabilities	3,838	3,385	4,287	4,850	5,141
Bonds payable	199,133	224,704	278,045	251,621	274,267
Other liabilities	307,705	336,664	387,574	402,625	440,875
Total liabilities	11,819,073	12,912,822	14,067,954	15,338,780	16,564,560
Equity:					
Share capital	279,147	279,365	288,731	348,731	348,731
Reserves and retained profit	545,530	644,551	852,128	982,426	1,203,000
Non-controlling interests	36,865	37,561	42,569	45,000	47,000
Total equity	861,542	961,477	1,183,428	1,376,157	1,598,731
Total liabilities and equity	12,680,615	13,874,299	15,251,382	16,714,936	18,163,291

Figure 3: PER



BOC at lower than the average valuation since 2011...

Figure 4: PBR



Source: Company, CAP IQ, CGIHK Research

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BUY : share price will increase by >20% within 12 months in absolute terms

SELL : share price will decrease by >20% within 12 months in absolute terms

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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